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The Postal Service's Sole-Source Contract with Perot Systems Corporation

Statement of
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Comptroller General of the United States

Before the
Subcommittee on Federal Services, Post Office, and Civil Service, and
Subcommittee on Oversight of Government Management
Committee on Governmental Affairs
United States Senate

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POSTAL SERVICE CONTRACT WITH PEROT SYSTEMS CORPORATION
SUMMARY OF STATEMENT BY
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On May 27, 1988, following about 3 months of discussions and negotiations, the Postal Service signed a sole-source contract with Perot Systems Corporation to devise and implement efficiency improvements in postal telecommunications, delivery services, revenue protection, transportation, and mail transportation equipment.

As authorized by the Postal Reorganization Act, postal procurement regulations differ significantly from standards that govern other federal agencies. However, both encourage competition and neither prohibits sole-source contracts that are properly justified and approved. The concept of shared savings is also compatible with postal and general federal requirements.

GAO found that the Postal Service sought to comply with the requirements of its new procurement manual in awarding the Perot contract. Nonetheless, the contract is loosely written in key particulars and does not adequately protect the interests of the Postal Service, its ratepayers, and the government. GAO's principal concerns fall in four areas:

-- The contract gives Perot Systems ownership of the ideas embodied in projects it will propose and reserves to Perot for 5 years the right to implement any portion of each proposed project.

-- The contract provides for the sharing of savings but specifies no ceiling on Perot's proportional share. The extent of sharing is to be determined through project-by-project negotiation with Perot in a strong bargaining position.

-- The contract, contrary to standard government practice, limits the ability of the Postal Service to terminate for convenience and provides no cost limit. In the event the Postal Service does terminate for convenience, Perot is entitled to 50 percent of its share of savings for the remaining term of the 10-year contract.

-- The contract was awarded on a sole-source basis without adequate justification.

Chairman Pryor, Chairman Levin, and Members of the Subcommittees:

We are pleased to be here today to assist the Senate in its inquiry into the Postal Service's award of a sole-source contract to Perot Systems Corporation on May 27, 1988. My testimony covers the following areas which we agreed to address in response to your request and the sense of the Senate resolution adopted on June 22:

-- How the contract came about;

-- Whether the Postal Service complied with its own procurement regulations, particularly those which govern competition in contracting, in awarding the contract to Perot Systems;

-- Whether unique features of the contract adequately protect the interests of ratepayers, the Postal Service, and the government in general;

-- Precedents for the shared savings concept in the contract that allows Perot Systems to share in the savings from projects it proposes and implements.

We reviewed the contract files and other documents relating to the contract and we interviewed Mr. Perot and responsible Postal Service officials including the Postmaster General; the

Assistant Postmaster General for Procurement and Supply; and the Contracting Officer, who is also the Director of the Office of Procurement.

Since completion of our review, the General Services Administration Board of Contract Appeals (GSBCA) has issued a decision holding that the contract between the Postal Service and Perot Systems is void. The principal ground for the Board's decision is that the Postal Service, insofar as it engages in automatic data processing equipment contracts, is covered by the Brooks Act. Therefore, the Board ruled that, under the Brooks Act, the Service is subject to the jurisdiction of GSBCA and that, in awarding the contract, the Postal Service failed to satisfy several of the Brooks Act's requirements. The Board also found that Postal Service had not followed all applicable provisions of its own procurement manual.

The Postal Service strongly disagrees with GSBCA's view of the applicability of the Brooks Act, maintaining that all Postal Service contracts are subject only to the provisions of its own procurement manual. Our work was conducted on the basis of the Postal Service's view that its own rules govern its contracting authority.

BACKGROUND ON THE CONTRACT

WITH PEROT SYSTEMS CORPORATION

Soon after his selection, Postmaster General Frank was told by a member of the Postal Service Board of Governors (Mr. Setrakian) that H. Ross Perot might be interested in helping him improve the Postal Service. Mr. Perot had been one of the people contacted by the Board's Selection Committee in its search for a new Postmaster General. In response to this suggestion, Mr. Frank visited Mr. Perot in Dallas and invited him to address the Postal Service Board of Governors at an informal dinner meeting on March 7, 1988. During the meeting Mr. Perot shared his management and leadership philosophies and expressed an interest in the challenges faced by the Postal Service. Following the dinner meeting Mr. Frank arranged for Mr. Perot to tour several postal facilities in the Dallas area on March 17-18, 1988.

Both Mr. Frank and Mr. Perot remained interested in reaching an agreement and in late March and early April 1988 senior postal officials internally discussed the pros and cons of contracting with Perot Systems Corporation and, if so, what areas should be included in the contract. On April 25, 1988, the Senior Management Council made the decision to continue discussions with Mr. Perot.

A Postal Service negotiation team composed of senior officials representing the Management Information and Research Technology Group, Office of General Counsel, Office of Procurement, and the Special Assistant to the Deputy Postmaster General, traveled to Dallas to meet with Mr. Perot. The first meeting took place on the evening of April 28, 1988, and intermittent negotiations continued with Mr. Perot and his attorneys through May 25, 1988.

On that date, Postmaster General Frank met with the negotiation team to discuss the status of the negotiations. Following a discussion of the pros and cons of the proposed agreement, he made a decision to proceed with the contract.

On May 26, 1988, final contract language was agreed to, the Director of the Office of Procurement prepared a recommendation to award the contract, and a noncompetitive award was approved by the Assistant Postmaster General for Procurement and Supply, Mr. John Davin. Mr. Davin's approval pointed out that because of the unusual nature of the study and implementation phases covered by the contract, he would require a "full business review" before making a decision to proceed beyond the study phase with any project.

The contract, which is dated May 26, 1988, was signed by the Contracting Officer (Mr. Strange) and was accepted by Mr. Perot for Perot Systems Corporation on May 27, 1988.

The agreement is a two-phase contract with an initial study period expected to last 90 days. During the initial phase Perot Systems will study five major Postal Service functions for ways to increase efficiency and cut costs. The functional areas are transportation, telecommunications, delivery services, revenue protection, and mail transportation equipment. Upon completion of each study Perot Systems Corporation is required to submit a report, including among other things:

-- a statement of work for Perot Systems Corporation operational or management services,

-- an implementation plan and schedule for each project,

-- a description of current Postal Service base costs for each operation, and

-- a proposal for computing and sharing the savings resulting from operational improvements.

The Postal Service will then decide whether to proceed with any study proposal into implementation. Each implementation project will be separately negotiated and approved.

COMPLIANCE WITH POSTAL PROCUREMENT MANUAL

When the Postal Reorganization Act was passed in 1970, the Postal Service was exempted from contracting laws applicable to federal agencies. The service then issued its own procurement regulations and has issued a second procurement manual which became effective on June 1, 1988. Because the contract was not to start until June 6, 1988, the Assistant Postmaster General for Procurement and Supply approved application of the new manual notwithstanding that the contract was signed in May.

We found that the Postal Service sought to comply with the requirements of its new procurement manual in awarding the Perot Systems contract. The new manual departs significantly from standards that govern procurement by other federal agencies. It adopts what the Postal Service considers are the best features from private and public procurement practices. It establishes a general policy of "adequate competition from qualified sources" in contrast to the federal policy of "full and open" competition. Both the new postal manual and federal procurement regulations permit noncompetitive contract awards when properly justified and approved. Finally, apart from their specific content, the postal manual is a more directory document in its application in contrast to the mandatory structure of federal procurement regulations.

These differences aside, it is our opinion that the contract is loosely written in some key particulars. The contract as it now stands does not adequately protect the interests of the Postal Service, the ratepayers, or the government. We have four principal areas of concern:

-- Perot's rights to ideas,

-- Lack of a ceiling on Perot's share of savings,

-- Limited ability of the Postal Service to terminate for convenience, and

-- Adequacy of the sole-source justification.

UNUSUAL FEATURES OF THE PEROT SYSTEMS CONTRACT

The Postal Service contract with Perot Systems contains several provisions that constitute a marked departure from standard practice.

Perot's Rights to Ideas

The contract gives the Postal Service the right to approve or reject projects that are proposed by Perot Systems Corporation. However, the contract establishes a "mutual expectation" that each project will be approved unless the Postal Service reasonably determines that implementation would be contrary to its business objectives and policies.

The contract also provides that the Postal Service will not, without prior approval of Perot Systems, implement any project or portion thereof independently at any time prior to the fifth anniversary of the effective date of the contract. If a project is implemented after the fifth anniversary, Perot Systems is entitled to compete for the contract to the same extent as any other party.

The contract does not specify what is to happen in the event the Postal Service disapproves or delays the implementation of a proposed project. While the Postal Service has the right to reject projects under the contract, Perot Systems also has rights to projects it proposes. As we read the contract, the Postal Service may not, without Perot Systems approval, implement any project or portion of a project proposed by Perot Systems but not approved by the Postal Service. The Postal Service asserts that the 5-year exclusive rights provision was intended to apply only

to approved projects. We are concerned that this portion of the contract could result in reduced management flexibility for the Postal Service. Because the contract is, at best, unclear, we are also concerned about the possibility that Perot Systems could submit future claims for projects or parts thereof that were not approved by the Postal Service during negotiations for implementation but were subsequently initiated by the Postal Service.

Further, the contract is unclear as to Perot's rights to ideas that are either similar to or based in whole or in part on previous work or studies that postal employees or others have done. This could be a problem in the future unless Perot Systems' ideas are so unique and novel as to never have been considered before by the thousands of people involved in or familiar with postal operations.

These contract ambiguities are invitations for protracted litigation, with the potential effect of undermining the Postal Service's ability to institute needed cost efficient reforms.

Lack of a Ceiling on Perot's
Share of Savings

The contract calls for the Postal Service and Perot Systems to share the savings resulting from projects beginning December 1,

1989. This date was selected because Mr. Perot's agreement with General Motors prohibits him from for-profit enterprises until then. However, the contract does not contain limits on how large a share either party would receive. During negotiations, Perot Systems argued strongly for a 50-50 split in the contract, but Postal negotiators felt that proportion might result in inordinate profits for Perot. The respective shares on a percentage basis are now required to be agreed upon project-by-project prior to commencing each project.

Lack of an advance agreement on how the savings will be shared has contributed to speculation that Perot Systems could make very high profits on this contract. The contract places Perot Systems in a very strong bargaining position by forbidding Postal Service implementation of the projects independent of Perot and by establishing a "mutual expectation" that reasonable projects will be approved.

Limited Ability of the Postal Service
to Terminate for Convenience

Both Postal Service and other government contracts generally allow federal agencies to terminate for convenience without liability for breach of contract damages any time a contracting officer determines continuation of the contract is not in the best interest of the government. They also establish a limit on

cost to the government. The Perot Systems contract contains no cost limit provision. Further, it prohibits the Postal Service from terminating for convenience during the period beyond the 90-day study phase until 2 years after the effective date of contract award. A separate agreement between Mr. Perot and the Postal Service permits the Service to terminate the contract during the study phase if the contracting officer determines that continuation is not in the best interest of the Postal Service. The modified termination for convenience clause, which applies after the first 90 days, entitles Perot Systems to 50 percent of the share of savings that would have been paid had the contract not been terminated prior to the end of its intended 10-year life.

According to postal officials, the termination for convenience clause was modified because Mr. Perot wanted to be guaranteed the opportunity to implement his ideas and because Perot Systems, pursuant to Mr. Perot's prior agreement with General Motors, could make no profits for 18 months. Termination within that period would have allowed Perot Systems no profits for its work. The failure to use the standard termination for convenience clause in itself may have presented only a limited risk. This failure, however, coupled with the guarantee to Perot Systems of 50 percent of its projected savings share for the remaining years of the contract if the Postal Service should terminate at some point, is cause for concern.

Adequacy of the Sole-Source Justification

The Postal Service prepared a formal sole-source justification that was approved by the appropriate postal officials, but we found the justification unconvincing and that it did not comply with applicable Postal Service requirements.

The written justification focuses on the unique capabilities of H. Ross Perot for this effort but fails to establish that he is the only one who can perform the required work and fails to consider the qualifications of others. It expounds on his skills, image, past track record, and on his decisiveness and innovativeness. While the justification emphasizes Mr. Perot's personal qualities, the contract does not require any commitment of his time.

The Postal Service has authority to deviate from any of its manual provisions, including those having to do with competitive and noncompetitive contract awards, even, apparently, after award of a contract is challenged. See Morgan Associates v. United States Postal Service, 511 F.2d 1223 (2d Cir. 1975). In the Perot contract, the Postal Service did not seek to deviate, but in our view, its attempt to justify the sole-source award plainly failed.

PRECEDENTS FOR THE
SHARED SAVINGS CONCEPT

You also asked us whether there are precedents in federal contracting for the shared savings method of compensation embodied in the Perot Systems contract.

There are precedents for the shared savings concept in federal contracting. Value engineering, for example, provides for the sharing of savings resulting from engineering change proposals suggested by contractors and accepted by the government. Sharing in the savings resulting from contract costs ultimately being less than a set target would be another example.

Yet another example where the shared savings concept is being applied is in the area of energy savings. The Postal Service awarded the federal government's first shared energy savings contract in December of last year. This contract is a lighting retrofit project for the San Diego General Mail Facility. It calls for retrofitting 2,292 fluorescent lighting fixtures with energy-efficient ballasts, reflectors and new lamps. The Postal Service expects its share of savings to be about $600,000 during the 7 years of this contract. While this contract is an example of sharing savings, we do not believe it is similar to the Perot Systems contract because (1) it was competitively awarded and (2) the winning contractor was required to incur all the costs

for the project. In contrast, the Perot Systems contract was a noncompetitive award and provides for reimbursement of all approved costs.

We identified 13 other shared federal energy savings initiatives under consideration by several federal agencies, including the General Services Administration, and the Departments of Energy, Defense, and Housing and Urban Development. While these projects are in varying stages, none has yet been put under contract.

That concludes my statement. We will be pleased to respond to any questions.